Condensed interim consolidated financial statements of
MTY Food Group Inc.

For the three-month periods ended February 29, 2020 and February 28, 2019

(Unaudited)

MTY Food Group Inc.

Condensed interim consolidated statements of income

For the three-month periods ended February 29, 2020 and February 28, 2019
(In thousands of Canadian dollars, except per share amounts)
(Unaudited)

	Notes	**February 29, 2020**	February 28, 2019
		$	$
Revenue	12	**150,780**	107,297
Expenses			
Operating expenses	13	**110,049**	78,921
Depreciation – property, plant and equipment and right-of-use assets		**3,841**	739
Amortization – intangible assets		**7,155**	6,551
Interest on long-term debt		**5,178**	3,142
Net interest expense on leases	6	**602**	—
Impairment charge on right-of-use assets	6	**227**	—
		127,052	89,353
Share of net profit of a joint venture accounted for using the equity method		**306**	—
Other income (charges)			
Unrealized and realized foreign exchange gain (loss)		**(100)**	8
Interest income		**182**	165
Gain (loss) on disposal of property, plant and equipment, right-of-use assets and intangible assets		**(173)**	73
Gain on revaluation of financial liabilities recorded at fair value through profit and loss		**197**	996
		106	1,242
Income before taxes		**24,140**	19,186
Income tax expense (recovery)			
Current		**3,962**	5,287
Deferred		**1,123**	(885)
		5,085	4,402
Net income		**19,055**	14,784
Net income attributable to:			
Owners		**19,008**	**14,748**
Non-controlling interest		**47**	**36**
		19,055	**14,784**
Income per share	9		
Basic		**0.76**	0.59
Diluted		**0.76**	0.58

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

MTY Food Group Inc.

Condensed interim consolidated statements of comprehensive income

For the three-month periods ended February 29, 2020 and February 28, 2019
(In thousands of Canadian dollars, except per share amounts)
(Unaudited)

	February 29, 2020	February 28, 2019
	$	$
Net income	**19,055**	14,784
Items that may be reclassified subsequently to net income:		
Unrealized gain (loss) on translation of foreign operations	**8,006**	(4,414)
Deferred income tax recovery (expense) on foreign currency translation adjustments	**(538)**	323
Other comprehensive income (loss)	**7,468**	(4,091)
Total comprehensive income	**26,523**	10,693
Total comprehensive income attributable to:		
Owners	**26,476**	10,657
Non-controlling interest	**47**	36
	26,523	10,693

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

MTY Food Group Inc.

Condensed interim consolidated statements of changes in shareholders' equity

For the three-month periods ended February 29, 2020 and February 28, 2019

(In thousands of Canadian dollars, except per share amounts)

(Unaudited)

	Capital stock	Reserves: Other	Reserves: Contributed surplus	Reserves: Foreign currency translation	Reserves: Total reserves	Retained earnings	Total	Equity attributable to non-controlling interest	Total
	$	$	$	$	$	$	$	$	$
For the three months ended February 29, 2020									
Balance, beginning of period	310,939	(850)	2,095	(736)	509	353,300	664,748	732	665,480
Adjustment on adoption of IFRS 16 (net of tax) (Note 3)	—	—	—	—	—	(10,692)	(10,692)	—	(10,692)
Adjusted balance, beginning of period	**310,939**	**(850)**	**2,095**	**(736)**	**509**	**342,608**	**654,056**	**732**	**654,788**
Net income	—	—	—	—	—	19,008	19,008	47	19,055
Other comprehensive income	—	—	—	7,468	7,468	—	7,468	—	7,468
Total comprehensive income							26,476	47	26,523
Shares repurchased and cancelled (Note 10)	(2,245)	—	—	—	—	(7,415)	(9,660)	—	(9,660)
Dividends	—	—	—	—	—	(4,633)	(4,633)	—	(4,633)
Shared-based compensation	—	—	246	—	246	—	246	—	246
Balance, end of period	**308,694**	**(850)**	**2,341**	**6,732**	**8,223**	**349,568**	**666,485**	**779**	**667,264**

	Capital stock	Reserves: Other	Reserves: Contributed surplus	Reserves: Foreign currency translation	Reserves: Total reserves	Retained earnings	Total	Equity attributable to non-controlling interest	Total
	$	$	$	$	$	$	$	$	$
For the three months ended February 28, 2019									
Balance, beginning of period	312,161	(850)	1,512	450	1,112	296,341	609,614	1,281	610,895
Net income	—	—	—	—	—	14,748	14,748	36	14,784
Other comprehensive loss	—	—	—	(4,091)	(4,091)	—	(4,091)	—	(4,091)
Total comprehensive income							10,657	36	10,693
Dividends	—	—	—	—	—	(4,257)	(4,257)	(25)	(4,282)
Shared-based compensation	—	—	155	—	155	—	155	—	155
Balance, end of period	312,161	(850)	1,667	(3,641)	(2,824)	306,832	616,169	1,292	617,461

The accompanying notes are an integral part of the unaudited condensed interim consolidated financial statements.

MTY Food Group Inc.
Condensed interim consolidated statements of financial position
As at February 29, 2020 and November 30, 2019
(In thousands of Canadian dollars, except per share amounts)
(Unaudited)

	Notes	February 29, 2020	November 30, 2019
		$	$
			Restated (note 4)
Assets			
Current assets			
Cash		**56,780**	50,737
Accounts receivable	5	**70,460**	65,129
Inventories		**9,587**	7,531
Assets held for sale		**9,693**	10,459
Loans receivable		**1,870**	4,082
Finance lease receivables	6	**99,628**	—
Income taxes receivable		**102**	563
Other assets		**2,208**	2,008
Prepaid expenses and deposits		**9,917**	9,284
		260,245	149,793
Loans receivable		**3,377**	3,063
Finance lease receivables	6	**416,389**	—
Contract cost asset		**5,375**	6,074
Deferred income tax		**1,775**	238
Investment in a joint venture	7	**28,342**	—
Property, plant and equipment		**20,607**	21,363
Right-of-use-assets	6	**71,152**	—
Intangible assets		**957,882**	958,099
Goodwill		**513,497**	510,171
		2,278,641	1,648,801
Liabilities and Shareholders' equity			
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities		**97,758**	100,762
Provisions		**10,624**	13,421
Gift card and loyalty program liabilities		**99,715**	92,800
Income taxes payable		**17,965**	20,506
Deferred revenue and deposits		**16,239**	18,761
Current portion of long-term debt	8	**5,599**	4,592
Current portion of lease liabilities		**115,223**	—
		363,123	250,842
Long-term debt	8	**556,126**	536,058
Lease liabilities		**487,985**	—
Deferred revenue and deposits		**45,274**	38,216
Deferred income taxes		**158,869**	158,205
		1,611,377	983,321

MTY Food Group Inc.

Condensed interim consolidated statements of financial position (continued)

As at February 29, 2020 and November 30, 2019

(In thousands of Canadian dollars, except per share amounts)

(Unaudited)

	February 29, 2020	November 30, 2019
	$	$ *Restated (note 4)*
Shareholders' equity		
Equity attributable to owners		
Capital stock	**308,694**	310,939
Reserves	**8,223**	509
Retained earnings	**349,568**	353,300
	666,485	664,748
Equity attributable to non-controlling interest	**779**	732
	667,264	665,480
	2,278,641	1,648,801

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

Approved by the Board on April 30, 2020

____, Director

____, Director

MTY Food Group Inc.

Condensed interim consolidated statements of cash flows

For the three-month periods ended February 29, 2020 and February 28, 2019

(In thousands of Canadian dollars, except per share amounts)

(Unaudited)

	Notes	February 29, 2020	February 28, 2019
		$	$
Operating activities			
Net income		**19,055**	14,784
Adjusting items:			
Interest expense on long-term debt		**5,178**	3,142
Net interest expense on leases	6	**602**	—
Depreciation – property, plant and equipment and right-of-use assets		**3,841**	739
Amortization – intangible assets		**7,155**	6,551
Loss (gain) on disposal of property, plant and equipment. right-of-use assets and intangible assets		**173**	(73)
Impairment charge on right-of-use assets	6	**227**	—
Share of profits of a joint venture		**(306)**	—
Gain on revaluation of financial liabilities recorded at fair value through profit and loss		**(197)**	(996)
Income tax expense		**5,085**	4,402
Share-based payments		**246**	155
		41,059	28,704
Income taxes paid		**(6,094)**	(5,792)
Interest paid		**(4,768)**	(2,592)
Other		**(290)**	—
Changes in non-cash working capital items	15	**1,073**	6,437
Cash flows provided by operating activities		**30,980**	26,757
Investing activities			
Net cash outflow on acquisitions		**—**	(20,906)
Additions to property, plant and equipment		**(1,119)**	(1,954)
Additions to intangible assets		**(649)**	(64)
Proceeds on disposal of property, plant and equipment and assets held for sale		**1,526**	175
Investment in a joint venture	7	**(19,105)**	—
Cash flows used in investing activities		**(19,347)**	(22,749)

(In thousands of Canadian dollars, except per share amounts)

	Notes	February 29, 2020	February 28, 2019
		$	$
Financing activities			
Issuance of long-term debt		**20,000**	23,000
Repayment of long-term debt		**(8,487)**	(14,358)
Lease payments		**(3,618)**	—
Shares repurchased and cancelled	10	**(9,660)**	—
Dividends paid to non-controlling shareholders of subsidiaries		**—**	(25)
Dividends paid		**(4,633)**	(4,257)
Cash flows provided by (used in) financing activities		**(6,398)**	4,360
Net increase in cash		**5,235**	8,368
Effect of foreign exchange rate changes on cash		**808**	(315)
Cash, beginning of period		**50,737**	32,304
Cash, end of period		**56,780**	40,357

The accompanying notes are an integral part of the condensed interim consolidated financial statements.

Table of contents – Notes to the condensed interim consolidated financial statements

1. Description of the business

MTY Food Group Inc. (the "Company") is a franchisor in the quick service and casual dining food industry. Its activities consist of franchising and operating corporate-owned locations as well as the sale of retail products under a multitude of banners. The Company also operates a distribution center and a food-processing plant, both of which are located in the province of Quebec.

The Company is incorporated under the *Canada Business Corporations Act* and is listed on the Toronto Stock Exchange ("TSX"). The Company's head office is located at 8210, Trans-Canada Highway, Ville Saint-Laurent, Quebec.

2. Basis of preparation

The unaudited condensed interim consolidated financial statements ("financial statements") have been prepared on the historical cost basis except for certain financial instruments that are measured at revalued amounts or fair values at the end of each reporting period, as explained in the accounting policies below.

Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Company takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these financial statements is determined on such a basis, except for share-based payment transactions that are within the scope of International Financial Reporting Standards ("IFRS") 2, Leasing Transactions, that are within the scope of IFRS 16, Leases, and measurements that have some similarities to fair value but are not fair value, such as net realizable value in International Accounting Standards ("IAS") 2, Inventories, or value in use in IAS 36, Impairment of Assets.

In addition, for financial reporting purposes, fair value measurements are categorized into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

The financial statements are presented in Canadian dollars, which is the functional currency of the Company, and tabular amounts are rounded to the nearest thousand ($000) except when otherwise indicated.

Statement of compliance

The Company's unaudited condensed interim consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34, Interim Financial Reporting and apply the same accounting policies as those described in the Company's annual consolidated financial statements for the year ended November 30, 2019, prepared in accordance with IFRS as issued by the International Accounting Standards Board ("IASB"), with the exception of joint arrangements disclosed below or in Note 3 to these financial statements.

These financial statements do not include all of the information required under IFRS for complete financial statements and should therefore be read in conjunction with the Company's annual consolidated financial statements for the year ended November 30, 2019.

The financial statements were authorized for issue by the Board of Directors on April 30, 2020.

2. Basis of preparation (continued)

Joint arrangements

Joint arrangements are arrangements in which the Company exercises joint control as established by contracts requiring unanimous consent for decisions about the activities that significantly affect the arrangement's returns. When the Company has the rights to the net assets of the arrangement, the arrangement is classified as a joint venture and is accounted for using the equity method. When the Company has rights to the assets and obligations for the liabilities relating to an arrangement, the arrangement is classified as a joint operation and the Company accounts for each of its assets, liabilities and transactions, including its share of those held or incurred jointly, in relation to the joint operation.

Under the equity method of accounting, interests in joint ventures are initially recognized at cost and adjusted thereafter to recognize the Company's share of the profits or losses and movements in other comprehensive income (OCI) of the investee. When the Company's share of losses in a joint venture equals or exceeds its interests in the joint ventures, the Company does not recognize further losses unless it will incur obligations or make payments on behalf of the joint ventures.

Unrealized gains resulting from transactions with joint ventures are eliminated, to the extent of the Company's share in the joint venture. For sales of products or services from the Company to its joint ventures, the elimination of unrealized profits is considered in the carrying value of the investment in equity-accounted investees in the condensed interim consolidated statement of financial position and in the share in profit or loss of equity-accounted investees in the condensed interim consolidated statement of income.

3. Changes in accounting policies

Policies applicable beginning December 1, 2019

Impact of the application of IFRS 16, Leases

On December 1, 2019, the Company adopted IFRS 16 using the modified retrospective approach. The Company has not restated the comparatives for the 2019 financial year as permitted under the specific transitional provisions in the standard. The impact from the new leasing standard is therefore recognized in the opening balance sheet on December 1, 2019.

IFRS 16 introduces new or amended requirements with respect to lease accounting. The standard provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors. It supersedes IAS 17, Leases and its associated interpretive guidance. It introduces significant changes to lessee accounting by removing the distinction between operating and finance leases and requiring the recognition of a right-of-use asset and corresponding lease liability at the commencement of all leases (subject to limited exceptions for short-term leases and leases of low-value assets). Lease-related expenses previously recorded in operating expenses, primarily as occupancy costs will be recorded as depreciation on the right-of-use assets and a finance charge from unwinding the discount on the lease liabilities. When the Company is the lessor, lease-related revenues previously recorded in rental revenue will be recorded as finance income. IFRS 16 will also change the presentation of cash flows relating to leases in the Company's consolidated statements of cash flows, but it does not cause a difference in the amount of cash transferred between the parties of a lease. Although the standard did not change the accounting for most lessors significantly, it does change the manner in which intermediate lessor determines the classification of sublease arrangements between operating and finance leases. Under IFRS 16, this assessment is determined relative to whether the sublease transfers significant risks and rewards of the right-of-use asset.

In applying IFRS 16 for the first time, the Company has elected to use the following practical expedients permitted by the standard:

- the Company has not reassessed, under IFRS 16, contracts that were identified as leases under the previous accounting standards (IAS 17 and IFRIC 4);
- the use of the provision for onerous leases as an alternative to performing an impairment review;

(In thousands of Canadian dollars, except per share amounts)

3. Changes in accounting policies (continued)

Impact of the application of IFRS 16, Leases (continued)

- the right to exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application;
- the accounting for operating leases with a remaining lease term of less than 12 months as at December 1, 2019 as short-term leases and leases for which the underlying asset is of low value;
- the use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

The impact of the adoption of IFRS 16 on the Company's financial statements is described below.

Impact on lessee accounting

IFRS 16 changes how the Company accounts for leases previously classified as operating leases under IAS 17, which were off-balance-sheet.

Applying IFRS 16, for all leases (except as noted below), the Company;

- recognized right-of-use assets and lease liabilities in the consolidated statements of financial position, initially measured at the present value of future lease payments;
- recognized depreciation of right-of-use assets and interest on lease liabilities in the consolidated statements of income; and
- separated the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within operating activities) in the consolidated statements of cash flows.

Under IFRS 16, right-of-use assets are tested for impairment in accordance with IAS 36, Impairment of Assets. This replaces the previous requirement to recognize a provision for onerous lease contracts.

For short-term leases (lease term of 12 months or less) and leases of low-value assets, the Company has opted to recognize a lease expense on a straight-line basis as permitted by IFRS 16. This expense is presented within operating expenses, primarily as occupancy costs in the consolidated statements of income.

On adoption of IFRS 16, the Company recognized lease liabilities in relation to leases which had previously been classified as operating leases under the principles of IAS 17. These liabilities were measured at the present value of the remaining lease payments, discounted using the Company's incremental borrowing rate as of December 1, 2019. The weighted average lessee's incremental borrowing rate applied to the lease liabilities on December 1, 2019 was 2.749%.

The following table reconciles the operating lease commitments as at November 30, 2019 to the opening balance of lease liabilities as at December 1, 2019:

	$
Operating lease commitments disclosed as at November 30, 2019	**648,445**
Discounted using the Company's incremental borrowing rate at December 1, 2019	(52,507)
Short-term leases and low-value leases	(16,228)
Adjustments as a result of a different treatment of extension and termination options	34,478
Other	(3,109)
Lease liabilities recognized as at December 1, 2019	**611,079**

(In thousands of Canadian dollars, except per share amounts)

3. Changes in accounting policies (continued)

Impact of the application of IFRS 16, Leases (continued)

The associated right-of-use assets were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments and impairment relating to that lease recognized in the consolidated statements of financial position as at December 1, 2019.

Impact on lessor accounting

As a lessor, leases are still classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases. When the Company enters into a sublease arrangement as an intermediate lessor, the Company accounts for the head lease and the sublease as two separate contracts. The Company is required to classify the sublease as a finance or operating lease by reference to the right-of-use asset arising from the head lease.

For finance subleases, the Company derecognizes the right-of-use asset relating to the head lease that is transferred to the sublessee and recognizes a finance lease receivable in the sublease. Any difference between the right-of-use asset and finance lease receivable is recognized as a gain or loss in the consolidated statements of income. As the intermediate lessor, the Company retains the lease liability on the head lease in its consolidated statement of financial position. During the term of the sublease, the Company recognizes both finance income on the sublease and interest expenses on the head lease.

As a result of this change, the Company has reclassified most of its sublease arrangements as finance leases. As required by IFRS 9, an allowance for expected credit loss has been recognized on the finance lease receivables.

Financial impact of initial application of IFRS 16

The following table summarizes the adjustments to opening balances resulting from the initial adoption of IFRS 16:

	As previously reported under IAS 17 November 30, 2019	**IFRS 16 transition adjustments**	**December 1, 2019**
	$	$	**$**
Assets			
Current assets			
Finance lease receivables	**—**	98,256	**98,256**
Prepaid expenses and deposits	**9,284**	(1,972)	**7,312**
Finance lease receivables	**—**	428,165	**428,165**
Right-of-use assets	**—**	68,838	**68,838**
Liabilities			
Current liabilities			
Provisions	**13,163**	(1,274)	**11,889**
Deferred revenue and deposits	**18,761**	(2,089)	**16,672**
Current portion of lease liabilities	**—**	111,414	**111,414**
Lease liabilities	**—**	499,665	**499,665**
Deferred income taxes	**158,430**	(3,737)	**154,693**
Reserves			
Retained earnings	**353,300**	(10,692)	**342,608**

(In thousands of Canadian dollars, except per share amounts)

3. Changes in accounting policies (continued)

IFRIC 23 - Uncertainty over income tax treatments

In June 2017, the IASB released IFRIC 23 - Uncertainty over Income Tax Treatments, which addresses how to determine the taxable profit (loss), tax basis, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12, Income Taxes. It specifically considers whether tax treatments should be considered independently or collectively and assumptions for taxation authorities' examinations in regard to taxable profit (loss), tax bases, unused tax losses, unused tax credits or tax rates.

IFRIC 23 was adopted effective December 1, 2019 and resulted in no significant adjustment.

4. Business acquisitions

I) Papa Murphy's (2019)

On May 23, 2019, the Company, through the merger of a wholly owned United States (US) subsidiary with Papa Murphy's Holdings Inc. ("PM"), acquired all the outstanding shares of PM.

The purpose of the transaction was to diversify the Company's range of offering in the US with a new concept offering take-and-bake freshly made pizza.

	2019
	$
Consideration paid:	
Cash and amount paid for early settlement of options	257,596
Less: Cash acquired	(2,435)
Net consideration paid/cash outflow	255,161

(In thousands of Canadian dollars, except per share amounts)

4. Business acquisitions (continued)

l) Papa Murphy's (2019) (continued)

The final purchase price allocation is as follows:

				2019
	As previously reported		**Adjustments**	**Final purchase price allocation**
Net assets acquired:	**$**		**$**	**$**
Current assets				
Cash	2,435		—	2,435
Accounts receivable	3,873		—	3,873
Inventory	1,195		—	1,195
Prepaid expenses and deposits	2,344		—	2,344
Assets held for sale	20,366	(1&2)	(627)	19,739
	30,213			29,586
Property, plant and equipment	1,054		—	1,054
Other intangible assets	1,277		—	1,277
Franchise rights	45,259		—	45,259
Trademark	131,551		—	131,551
Goodwill	126,646	(1&2)	661	127,307
	336,000		34	336,034
Current liabilities				
Accounts payable and accrued liabilities	22,475		—	22,475
Provisions	12,093	(2)	261	12,354
Gift card liability	2,840		—	2,840
	37,408		261	37,669
Deferred income taxes	40,996	(1, 2)	(227)	40,769
	78,404		34	78,438
Net purchase price	257,596		—	257,596

(1) Goodwill is not deductible for tax purposes.

(2) The Company has recorded adjustments to its previously reported preliminary purchase price allocation reported as at November 30, 2019 for provisions and assets held for sale.

The purchase price allocation is final.

Total expenses incurred related to acquisition costs amounted to $4,209.

(In thousands of Canadian dollars, except per share amounts)

5. Accounts receivable

The following table provides details on trade accounts receivable not past due, past due and the related credit loss allowance.

	February 29, 2020	November 30, 2019
	$	$
Total accounts receivable	78,588	73,305
Less: Allowance for credit losses	8,128	8,176
Total accounts receivable, net	70,460	65,129
Of which:		
Not past due	47,227	48,273
Past due for more than 1 day but no more than 30 days	5,433	2,943
Past due for more than 31 days but no more than 60 days	3,745	2,433
Past due for more than 61 days	14,055	11,480
Total accounts receivable, net	70,460	65,129

6. Leases

Leases as a lessee relate primarily to leases of premises in relation to the Company's operations and its corporate store locations. For many of the leases related to its franchised locations, the Company is on the head lease of the premises and a corresponding sublease contract was entered into between the Company and its unrelated franchisee. The sublease contract is substantially based on the same terms and conditions as the head lease.

Leases and subleases typically have terms ranging between 5 and 10 years at inception. The Company does not have options to purchase the premises on any of its leases.

Right-of-use assets

The following table provides the net carrying amount of the right-of-use assets by class of underlying asset and the changes in the period ending February 29, 2020:

	Offices, corporate and dark stores	Store locations subject to operating subleases	Other	Total
	$	$	$	$
Beginning balance	55,937	12,088	813	68,838
Additions	5,546	—	—	5,546
Disposals	(829)	—	—	(829)
Depreciation expense	(2,279)	(322)	(48)	(2,649)
Impairment losses	(227)	—	—	(227)
Foreign exchange	493	—	(20)	473
Balance as at February 29, 2020	58,641	11,766	745	71,152

(In thousands of Canadian dollars, except per share amounts)

6. Leases (continued)

The following table provides the breakdown of interest revenues and expenses recognized in the condensed interim consolidated statement of income relating to leases where the Company is the lessee or lessor:

	Three-months ended February 29, 2020
	$
Interest income on finance lease receivables	**3,437**
Interest expense on lease liabilities	**(4,039)**
Net interest expense on lease	**(602)**

Maturity analysis

The following table sets out a maturity analysis of lease payments, showing the undiscounted lease payments to be paid or received after February 29,2020:

	Leases	Finance sublease receivable	Operating subleases
	$	$	$
2021	130,881	116,147	1,287
2022	120,396	105,320	1,140
2023	102,285	88,983	1,050
2024	82,999	71,627	858
2025	64,922	55,336	803
Thereafter	151,876	117,336	2,317
Total undiscounted lease payments	**653,359**	**554,749**	**7,455**
Unguaranteed residual values	—	3,142	—
Gross investment in the lease	—	**557,891**	**7,455**
Less Unearned finance income	—	(37,043)	—
Present value of minimum lease payment receivables	—	**520,848**	**7,455**
Allowance for credit losses	—	(4,831)	—
Current portion finance lease receivables	—	(99,628)	—
Finance lease receivables	—	**416,389**	—

The average effective interest rate contracted on the finance subleases is approximately 2.7%.

(In thousands of Canadian dollars, except per share amounts)

7. Interest in a joint venture

On December 3, 2019, one of the Company's wholly owned subsidiaries completed its acquisition of a 70% interest in a joint venture that acquired Turtle Jack's Muskoka Grill, COOP Wicked Chicken and Frat's Cucina (together "Tortoise Group"), three casual dining concepts operating in the province of Ontario, for a consideration of $27,857, which includes a deferred contingent consideration amounting to $5,959, an obligation for the premium to repurchase its partner in a joint venture of $2,793 and cash consideration of $19,105.The Company has recorded its interest as a long-term receivable. The Company has guaranteed liabilities of the joint venture amounting to $6,967, which are payable to Tortoise Group, upon the repurchase of the 30 % joint venture partner.

8. Long-term debt

	February 29, 2020	November 30, 2019
	$	$
Non-interest-bearing contract cancellation fees and holdbacks on acquisitions	**13,022**	14,423
Contingent consideration on acquisitions and joint venture interest (1)	**9,264**	3,874
Fair value of promissory notes for Houston Avenue Bar & Grill repayable May 2021 (note 11)	**335**	329
Fair value of promissory notes related to buyback obligation of Houston Avenue Bar & Grill and Industria Pizzeria + Bar (note 11) (2)	**2,779**	2,738
Fair value non-controlling interest buyback obligation in 10220396 Canada Inc. (note 11) (2)	**1,860**	1,549
Fair value non-controlling interest option in 9974644 Canada Inc. (note 11) (3)	**1,069**	964
Fair value obligation to repurchase partner in a joint venture. (note 11) (4)	**2,875**	—
Fair value of interest rate swap (note 11) (5)	**479**	—
Revolving credit facility payable to a syndicate of lenders (6)	**532,000**	518,922
Credit facility financing costs	**(1,958)**	(2,149)
	561,725	540,650
Less:Current portion	**(5,599)**	(4,592)
	556,126	536,058

(1) Yuzu Sushi (payable August 2021), Allô! Mon Coco (payable October 2020 and January 2022), Turtle Jack's (payable December 2022)
(2) Payable June 2022.
(3) Payable on demand.
(4) Maximum maturity date of December 2025.
(5) Interest rate swap is fixing the interest rate at 2.273% on $100,000 of the outstanding revolving credit facility until July 21, 2021.
(6) Under the revolving credit facility, the Company has the option to draw funds in Canadian or in US dollars, at its discretion. The facility's maturity is September 23, 2022 and must be repaid in full at that time. As at February 29, 2020, the Company had drawn C$532,000, (2019 – C$518,922) and had elected to pay interest based on the Canadian prime rate plus the applicable margins.

(In thousands of Canadian dollars, except per share amounts)

9. Income per share

The following table provides the weighted average number of common shares used in the calculation of basic income per share and that used for the purpose of diluted income per share:

	February 29, 2020	February 28, 2019
Weighted daily average number of common shares-basic	**24,890,191**	25,169,778
Assumed exercise of stock options [(1)]	**29,843**	50,724
Weighted daily average number of common shares-diluted	**24,920,034**	25,220,502

(1) The calculation of the assumed exercise of stock options includes the effect of the average unrecognized future compensation cost of dilutive options. The number of excluded options was 288,890 (2019 – nil).

10. Capital stock

On June 27, 2019, the Company announced the renewal of the normal course issuer bid (NCIB) to purchase up to 1,258,488 of its common shares. The NCIB began on July 3, 2019 and will end on July 2, 2020 or on such earlier date when the Company completes its purchases or elects to terminate the NCIB. These purchases will be made on the open market plus brokerage fees through the facilities of the TSX and/or alternative trading systems at the prevailing market price at the time of the transaction, in accordance with the TSX's applicable policies. All common shares purchased pursuant to the NCIB will be cancelled.

During the three-months ended February 29, 2020, the Company repurchased and cancelled a total of 181,044 (2019 – nil) common shares under the current NCIB, at a weighted average price of $53.36 per common share, for a total consideration of $9,660 (2019 – nil). An excess of $7,415 (2019 – nil) of the shares' repurchase value over their carrying amount was charged to retained earnings as share repurchase premiums.

11. Financial instruments

In the normal course of business, the Company uses various financial instruments which by their nature involve risk, including market risk and the credit risk of non-performance by counterparties. These financial instruments are subject to normal credit standards, financial controls, risk management, and monitoring procedures.

Fair value of recognized financial instruments

Promissory notes issued as part of its consideration for the acquisition of Houston Avenue Bar & Grill and Industria Pizzeria + Bar

The Company has three outstanding promissory notes that were recorded as part of the acquisition of Houston Avenue Bar & Grill and Industria Pizzeria + Bar.

A fair value remeasurement loss of $47 was recorded for these promissory notes for the three-month period ended February 29, 2020 (2019 – gain of $1,139).

Contingent considerations on acquisitions and joint venture interest

The Company issued as part of its consideration for the acquisition of Yuzu Sushi, Allô! Mon Coco and investment in Tortoise Group, contingent considerations to the vendors. These contingent considerations are subject to earn-out provisions, which are based on future earnings and are repayable in August 2021 for Yuzu Sushi; October 2020 and January 2022 for Allô! Mon Coco and December 2022 for Tortoise Group. These contingent considerations have been recorded at fair value and are remeasured on a recurring basis.

A fair value remeasurement gain of $569 was recorded for the contingent considerations for the three-month period ended February 29, 2020 (2019-nil).

(In thousands of Canadian dollars, except per share amounts)

11. Financial instruments (continued)

Fair value of recognized financial instruments (continued)

Obligations to repurchase non-controlling interests

The Company has entered into an agreement to purchase the shares of a minority interest shareholder of 9974644 Canada Inc. at the option of the holder at any time after December 9, 2017. The consideration is based on a multiplier of EBITDA, as prescribed by the terms of the shareholder agreement. The Company records a liability at fair value which is remeasured at each reporting period.

A fair value remeasurement loss of $105 for the three-month period ended February 29, 2020 (2019 – gain of $70) was recorded for this non-controlling interest obligation.

The Company, in conjunction with the acquisition of Houston Avenue Bar & Grill and Industria Pizzeria + Bar, entered into an agreement to acquire the non-controlling interest in 10220396 Canada Inc., in June 2022. The consideration to be paid for this acquisition will be based on future earnings. The Company recorded a liability at fair value (note 8) which is remeasured at each reporting period.

A fair value remeasurement loss of $311 for the three-month period ended February 29, 2020 (2019 – loss of $213) was recorded for this non-controlling interest obligation.

Obligation to repurchase partner in a joint venture

The Company, in conjunction with the acquisition of its 70% interest in a joint venture that acquired Tortoise Group, entered into an agreement to acquire the remaining 30% interest by December 2025. The consideration to be paid for this acquisition will be based on future earnings. The Company recorded a liability at fair value (note 8) which is remeasured at each reporting period.

A fair value re-measurement loss of $82 for the three-month period ended February 29, 2020 (2019 - nil) was recorded.

Interest rate swap

The Company holds an interest rate swap that is contracted to a fixed rate on a notional amount of $100,000 and that matures in July 21, 2021. The fair value of this interest rate swap amounted to $479 (2019 – nil) and the Company recorded a fair value remeasurement gain of $173 for the three-month period ended February 29, 2020 (2019 – nil).

Fair value hierarchy (1)

	Level 3	
	February 29, 2020	November 30, 2019
Financial liabilities	**$**	$
Promissory notes for Houston Avenue Bar & Grill	**335**	329
Promissory notes related to buyback obligation of Houston Avenue Bar & Grill and Industria Pizzeria + Bar	**2,779**	2,738
Contingent considerations on acquisitions and joint venture interest	**9,264**	3,874
Non-controlling interest buyback options	**2,929**	2,513
Obligation to repurchase partner in a joint venture	**2,875**	—
Financial liabilities	**18,182**	9,454

(1) The Company has an interest rate swap outstanding as at February 29, 2020 in a liability position amounting to $479, and it is classified as level 2.

The Company has determined that the fair value of its financial assets and financial liabilities with short-term maturities approximates their carrying value. These financial instruments include cash, accounts receivable, accounts payable and accrued liabilities and deposits. The table below shows the fair value and the carrying amount of other financial instruments as at February 29, 2020 and November 30, 2019. Since estimates are used to determine fair value, they must not be interpreted as being realizable in the event of a settlement of the instruments.

(In thousands of Canadian dollars, except per share amounts)

11. Financial instruments (continued)

Fair value of recognized financial instruments (continued)

	February 29, 2020		November 30, 2019	
	Carrying amount	**Fair value**	Carrying amount	Fair value
	$	**$**	$	$
Financial assets				
Loans receivable	**5,247**	**5,247**	7,145	7,145
Finance lease receivable	**516,017**	**516,017**	—	—
Financial liabilities				
Long-term debt (1)	**543,064**	**553,111**	531,196	542,147

(1) Excludes promissory notes, contingent considerations on acquisition, interest rate swap and obligations to repurchase non-controlling interests.

Determination of fair value

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Loans receivable and Finance lease receivable – The carrying amount for these financial instruments approximates fair value due to the short-term maturity of these instruments and/or the use of market interest rates.

Long-term debt – The fair value of long-term debt is determined using the present value of future cash flows under current financing agreements based on the Company's current estimated borrowing rate for similar debt.

12. Revenue

	Three months ended					
	February 29, 2020			February 28, 2019		
	Canada	US & International	**TOTAL**	Canada	US & International	**TOTAL**
	$	$	**$**	$	$	**$**
Royalties	20,933	27,770	**48,703**	19,116	15,400	34,516
Franchise and transfer fees	1,628	1,017	**2,645**	1,306	791	2,097
Retail, food-processing and distribution revenues	25,638	1,147	**26,785**	21,727	1,082	22,809
Sale of goods, including construction revenues	10,359	15,311	**25,670**	8,857	4,558	13,415
Gift card breakage income	174	1,561	**1,735**	240	1,572	1,812
Promotional funds	10,734	14,714	**25,448**	10,421	6,670	17,091
Other franchising revenue	10,543	6,704	**17,247**	8,669	5,134	13,803
Other	1,248	1,299	**2,547**	1,088	666	1,754
	81,257	69,523	**150,780**	71,424	35,873	107,297

(In thousands of Canadian dollars, except per share amounts)

13. Operating expenses

	Three months ended					
	February 29, 2020			February 28, 2019		
	Canada	US & International	**TOTAL**	Canada	US & International	**TOTAL**
	$	$	**$**	$	$	**$**
Cost of goods sold and rent	5,463	6,215	**11,678**	6,555	3,804	10,359
Retail, food-processing and distribution costs	23,168	—	**23,168**	19,753	—	19,753
Wages and benefits	12,163	18,115	**30,278**	10,931	8,843	19,774
Consulting and professional fees	2,751	2,058	**4,809**	1,791	1,428	3,219
Gift cards – related costs	—	2,443	**2,443**	—	2,557	2,557
Royalties	9	1,449	**1,458**	118	905	1,023
Promotional funds	10,734	14,714	**25,448**	10,421	6,670	17,091
Other (1)	4,254	6,513	**10,767**	3,528	1,617	5,145
	58,542	51,507	**110,049**	53,097	25,824	78,921

(1) Other operating expenses comprise mainly travel and promotional costs, credit losses and other office administration expenses.

14. Segmented information

Management monitors and evaluates the Company's results based on geographical segments; these two segments being Canada and US & International. The Company and its chief operating decision-maker assess the performance of each operating segment based on its segment profit and loss, which is equal to revenue less operating expenses. Within those geographical segments, the Company's chief operating decision-maker also assesses the performance of subdivisions based on the type of product or service provided. These subdivisions include franchising, corporate stores, food processing, retail and distribution, and promotional fund revenues and expenses. This information is disclosed below.

(In thousands of Canadian dollars, except per share amounts)

14. Segmented information (continued)

Below is a summary of each geographical and operating segment's performance during the three-month period ended February 29, 2020.

	CANADA						US & INTERNATIONAL						
	Franchising	Corporate	Processing, distribution and retail	Promotional funds	Interco	Total Canada	Franchising	Corporate	Processing, distribution and retail	Promotional funds	Interco	Total US & International	Total consolidated
	$	$	$	$	$	$	$	$	$	$	$	$	$
Revenue	**36,742**	**8,413**	**25,968**	**10,734**	**(600)**	**81,257**	**39,246**	**15,053**	**1,147**	**14,714**	**(637)**	**69,523**	**150,780**
Operating expenses	**16,900**	**8,223**	**23,362**	**10,734**	**(677)**	**58,542**	**22,416**	**14,937**	**—**	**14,714**	**(560)**	**51,507**	**110,049**
Segment profit (loss)	**19,842**	**190**	**2,606**	**—**	**77**	**22,715**	**16,830**	**116**	**1,147**	**—**	**(77)**	**18,016**	**40,731**

Below is a summary of each geographical and operating segment's performance during for the three-month period ended February 28, 2019.

	CANADA						US & INTERNATIONAL						
	Franchising	Corporate	Processing, distribution and retail	Promotional funds	Interco	Total Canada	Franchising	Corporate	Processing, distribution and retail	Promotional funds	Interco	Total US & International	Total consolidated
	$	$	$	$	$	$	$	$	$	$	$	$	$
Revenue	32,391	7,673	21,484	10,421	(545)	71,424	24,484	3,714	1,082	6,670	(77)	35,873	107,297
Operating expenses	15,316	8,463	19,519	10,421	(622)	53,097	14,748	4,406	—	6,670	—	25,824	78,921
Segment profit (loss)	17,075	(790)	1,965	—	77	18,327	9,736	(692)	1,082	—	(77)	10,049	28,376

(In thousands of Canadian dollars, except per share amounts)

15. Interim consolidated statement of cash flows

Changes in non-cash working capital items are as follows:

	February 29, 2020	February 28, 2019
	$	$
Accounts receivable	(4,447)	729
Inventories	(2,005)	364
Loans receivable	2,212	926
Prepaid expenses and deposits	(1,807)	(1,068)
Other assets	(200)	55
Accounts payable and accrued liabilities	(3,289)	(673)
Provisions	(2,536)	388
Gift card and loyalty program liabilities	6,941	4,244
Deferred revenue and deposits	6,204	1,472
	1,073	6,437

16. Related party transactions

Balances and transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation. Details of transactions between the Company and other related parties are disclosed below.

Compensation of key management personnel

The remuneration of key management personnel and directors during the three-month periods ended was as follows:

	February 29, 2020	February 28, 2019
	$	$
Short-term benefits	737	790
Share-based payment	268	171
Board member fees	19	18
Total remuneration of key management personnel	1,024	979

Key management personnel is composed of the Company's CEO, COO's and CFO. The remuneration of directors and key executives is determined by the Board of Directors having regard to the performance of individuals and market trends.

Given its widely held share base, the Company does not have an ultimate controlling party; its most important shareholder is its Chair of the Board of Directors, who controls 19.6% of the outstanding shares.

(In thousands of Canadian dollars, except per share amounts)

16. Related party transactions (continued)

The Company also pays employment benefits to individuals related to members of the key management personnel described above. Their total remuneration was as follows:

	February 29, 2020	February 28, 2019
	$	$
Short-term benefits	**131**	112
Share-based payment	**6**	5
Consulting services	**—**	18
Total remuneration of individuals related to key management personnel	**137**	135

The Company has entered into a consulting agreement with one of its joint venture associates to perform corporate business development and management consulting services and paid $42 to this associate for the three-month period ended February 29, 2020 (February 28, 2019 - nil) in consulting fees for the period.

17. Subsequent events

COVID-19

In December 2019, a novel strain of coronavirus was reported to have surfaced in China, later to be renamed COVID-19. The spread of this virus caused business disruption subsequent to the first quarter of 2020, beginning in March 2020, due to the closure or modified operating hours in certain restaurants, and traffic decline in Canada, the USA and internationally. Although some disruption was seen overseas during the Company's first quarter, these were not deemed to have a material impact. The Company's overall international system sales represent 4% of total system sales and the disruptions encountered during the first quarter were only in a few of the countries internationally.

Further, while the disruption is currently expected to be temporary, there is uncertainty around the duration. Continuous efforts are being made around the world at an attempt to stop the spread of this virus. The efforts to stop the virus impact the Company and its franchise network materially. Therefore, while we expect this matter to negatively impact the Company's results, the related medium to longer term financial impact cannot be reasonably estimated at this time. While the Company cannot forecast its financial impact, it expects the following categories on its interim consolidated statement of financial position to be impacted in the second quarter:

- Expected credit losses on accounts receivable, loans receivable and lease receivable
- Expected credit losses on lease guarantees
- There will be a trigger for impairment testing of franchise rights, trademarks:
    - As previously disclosed as at November 30, 2019, a change of 1% in discounts rates in the US would result in an additional impairment of one brand representing 0.7% of the total carrying value of the franchise rights and trademarks in that CGU. A change of 1% in discounts rates in Canada would result in an impairment of two brands representing 1.6% of the total carrying value of franchise rights and trademarks in that CGU.
- There will be a trigger for impairment testing of goodwill:
    - As previously disclosed as at November 30, 2019, for the US business segment, the recoverable amount of goodwill for all of the brands excluding Papa Murphy's would be breakeven using a discount rate of 8.9%, and 10.4% for Papa Murphy's. Moreover, in Canada the recoverable amount of goodwill for the CGU would be breakeven using a discount rate of 14.9%.

17. Subsequent events (continued)

COVID-19 (continued)

- Provisions for closed stores and related litigations and disputes
- Fair value adjustment on the $100,000 credit facility interest rate swap
- Changes to lease liability

Because of the anticipated decrease in revenues, the Company is taking cost control measures both internally and by working with business partners. As well, the Company has already taken some cost cutting measures in March and April by temporarily reducing its workforce across Canada and the USA by means of temporary lay offs and upper management wage reductions.

Management estimates that current liquidities and forecasted cash flows will be sufficient to meet the Company's obligations, commitments and budgeted expenditures for the next 12 months. However, the Company has certain existing financial ratios to meet with respect to its credit facilities, which it may not be in compliance with as of the second quarter. The Company is in negotiations with its lenders to amend the credit facilities and modify the relevant financial ratios and has no reasonable basis to believe that such negotiations will not result in the required amendments.

The severity of the impact will depend on multiple factors, including the following:

- Duration of the disruption in business
- Nature and timeline regarding the ability to re-open closed locations
- Duration of the royalty and ad fund deferral the Company is granting to its franchisee network and the capability of franchisees to resume normal payment of royalties in the future
- Government subsidies to franchisees and corporations
- Possible increases in the number of permanent closures
- Landlord concessions
- Interest rate fluctuations